



MONTANA STATE FUND

FISCAL YEAR 2011 ANNUAL BUDGET

Approved June 25, 2010

Montana's economic situation and workers' compensation environment continually evolve. Montana State Fund's future success is dependent upon our ability to adapt to the continual changes and to adjust operational strategies in an appropriate manner. We must continue to be responsive to the needs of the Montana businesses we serve and utilize the limited resources available to us to build upon past successes and maintain a strong, viable, and stable workers' compensation market for Montana businesses.

The fiscal year 2011 (FY11) budget request provides the funding to enable Montana State Fund (MSF) to continue our role as the leader in the Montana workers' compensation industry, implement our business plan initiatives, and efficiently and effectively support business operations. The FY11 Budget will provide the financial resources to support the FY11 Strategic Business Plan (SBP).

The FY11 SBP includes nine projects encompassed within the continuing enterprise-wide initiatives of:

- 1) **Workforce:** recruitment, development, and retention
- 2) **Customer Service:** constituency education and safety culture
- 3) **Infrastructure:** tools to enable our employees to provide service to our customers

The budget for SBP Initiative projects is \$1,171,139. The FY11 SBP provides additional detail on each initiative and the expected benefits to customers and MSF's operations.

I. Executive Summary – Statutory Operating Expense and Ratio

The FY11 Budget results in a statutory operating expense ratio attained through responsible management of the needs of MSF policyholders, injured employees, and Montana stakeholders. Based on the FY11 Annual Budget request and estimated FY11 Net Earned Premium, the estimated MSF statutory operating expense ratio is 27.80%.

The following displays net earned premiums, budget / projection / actuals, and the statutory operating expense ratios from FY08 forward to the FY11 estimates.

	FY11 Budget	FY10 Projection	FY10 Budget	FY09 Actuals	FY08 Actual
Net Earned Premiums (000)	\$153,941	\$165,826	\$186,520	\$203,976	\$230,965
Operational Expenditures (000)	\$48,204	\$53,302	\$56,357	\$50,233	\$55,524
Benefit Payments (000)	\$136,715	\$134,541	\$133,441	\$133,295	\$135,124
Total Budget / Expenditures (000)	\$184,919	\$187,843	\$189,799	\$183,528	\$190,648
Statutory Operating Expense Ratio	27.80%	28.70%	25.44%	19.29%	19.76%

The FY11 benefit payments increase from the FY10-3Q Projection of \$2.17 million or 1.6% is primarily driven by the addition of a new accident year's claim payments to estimates of fiscal year expenditures on existing claim liabilities. The benefit payments budget does not include contingency funds related to court decisions.

The FY11 operational expenditures decrease from the FY10-3Q Projection of \$5.1 million or 9.6% is primarily driven by the completion of the building project.

The *operational expenditures* of \$48,203,839, noted above, are for the fiscal year's budgeted expenditures and are different from the *MSF statutory operating expenses* of \$42,791,098 used in the MSF statutory operating expense ratio for two reasons:

- 1) The operating expense used in the statutory operating expense ratio includes budgeted and non-budgeted MSF (New Fund) operational expenditures.
 - ✓ The statutory operating expense excludes New Fund benefit payments and all expenditures and expenses of the Old Fund.
 - ✓ The statutory operating expense includes other expenses, non-budgeted items: Old Fund Administrative Expense Allocation; Investment Allocation; LAE Reserve Changes; and, Reinsurance Program Contingent Commission.
- 2) The statutory operating expense ratio includes Generally Accepted Accounting Principals (GAAP) adjustments for full accrual accounting such as:
 - ✓ Capitalization of equipment and intangible assets
 - ✓ Depreciation and amortization expenses
 - ✓ Compensated absences
 - ✓ Other Post Employment Benefits (OPEB)

The statutory operating expense is \$42,791,098. This is based on:

- Total operational expenditures budget of \$48,203,839
- less Old Fund operating and allocated loss adjustment expense of \$485,150
- less capitalized MSF equipment and intangible assets of \$141,000
- plus other statutory expenses of \$3,587,089
- plus GAAP accounting adjustments of \$5,150,320
- less contingent commission – reinsurance program of \$13,524,000

Statutory operating expense is then divided by the FY11 estimated net earned premium.

- Net earned premium budget estimate of \$153,940,603. This is based on a manual rate reduction of 4% for FY11 from FY10, economic factors impacting MSF policyholders, and competition in the Montana workers' compensation industry impacting retention and new business written.

The proposed FY11 Budget anticipates a 27.80% operating expense ratio. The FY10 projected operating expense ratio is 28.70%. The FY10 expense ratio approved with the budget was 25.44%. The FY11 statutory operating expense ratio decrease from the projected FY10 statutory operating expense ratio is primarily due to the reduction in estimated expense for loss adjustment expense - reserve changes.

The following table compares the MSF statutory operating expense ratio with the property and casualty insurance industry and other state funds based on 2008 data from 2009 A. M. Best's Aggregates & Averages.

A.M. Best's 2008 Total US PC Industry – (997 P&C Organizations)	A.M. Best's 2008 Work Comp Composite – (197 Organizations)	A.M. Best's 2008 Total US PC State Funds – (21 Organizations)	MSF FY08	MSF FY09	MSF Projected FY10	MSF Budget FY11
39.02%	44.42%	36.70%	19.76%	19.29%	28.70%	27.80%

II. Revenue

The premium revenue MSF generates in Montana's competitive workers' compensation insurance market, along with investment income, provides the funding for:

- Indemnity and medical claims MSF policyholders incur; and,
- Operating expenses.

For FY11 MSF is projecting net earned premium of \$153,940,603. The estimate includes:

- 27,223 policies written in FY11
- Manual rate change for FY11 of -4.00%
- Wage growth of 0.0%
- Retention rate at 88%

MSF estimates FY11 investment income of \$46,339,735. This is based on a weighted average net return on investments of 4.67%.

The following table displays the net earned premium estimated for FY11; FY10 projection; the FY10 Board approved premium estimate; and, actual FY09 premium.

	FY11 Budget Estimate	FY10 Projection	FY10 Budget Estimate	FY09 Actual
Net Earned Premium	\$153,940,603	\$165,825,645	\$186,519,814	\$203,976,354

III. Total Expenditures

The total budget request for FY11 expenditures is \$184,919,303. The FY11 budget is separated into five primary expenditure categories and displayed below with comparative expenditures from the 3rd quarter projection of FY10 and the approved FY10 budget.

Categories	FY11 Budget	FY10 Qtr Projection	FY10 Budget
MSF - Benefits and Claim Payments	\$127,037,055	\$125,900,880	\$122,461,770
Old Fund - Benefits and Claim Payments	9,678,409	8,639,992	10,979,552
Allocated Loss Adjustment Expenditures	4,606,552	4,615,782	4,573,637
Unallocated Loss Adjustment Expenditures	14,182,197	15,545,560	18,134,633
Underwriting Expenditures	29,415,089	33,140,816	33,649,014
Total Expenditures	\$184,919,303	\$187,843,030	\$189,798,606

IV. Benefit Payments

The FY11 total MSF budget includes funding of \$136,715,464 for benefit payments to injured employees. Benefit payments comprise 73.9% of the total FY11 MSF budget.

FY11 benefit payments are separated by New Fund and Old Fund and compared to the FY10 projected and FY09 actual expenditure levels below.

Benefit Payments (000s)	FY11 Budget	FY10 Projection	FY09 Actual	\$ Change FY11 from FY10 Proj.	% Change FY11 from FY10 Proj.
New Fund	\$127,037	\$125,901	\$122,460	\$1,136	0.9%
Old Fund	9,678	8,640	10,834	1,038	12.0%
Total	\$136,715	\$134,541	\$133,295	\$2,175	1.6%

New Fund Benefit Payments

\$127,037,055 is budgeted in the New Fund for payment of benefits to individuals in compliance with the state law governing claim payments. Based on payments activity, FY11 New Fund accident years benefit payments are:

- Indemnity - \$53.3 million or 42.0% of total medical and indemnity
- Medical - \$73.7 million or 58.0% of total medical and indemnity

The following table reflects the budgeted FY11 New Fund benefit payments, projected FY10 benefit payments, and nine years of actual payments.

<u>Fiscal Year</u>	<u>Benefit Payments</u>	<u>Percent Change from Prior Year</u>
FY11 Budget	\$127,037,055	0.9%
FY10 Projection	125,900,880	2.8%
FY09 Actual	122,460,166	-1.4%
FY08 Actual	124,139,778	7.2%
FY07 Actual	115,849,169	5.1%
FY06 Actual	110,237,048	11.9%
FY05 Actual	98,479,963	-1.8%
FY04 Actual	100,271,014	20.3%
FY03 Actual	83,319,729	22.7%
FY02 Actual	67,899,056	9.4%
FY01 Actual	62,068,055	

- New Fund accident years 1991 – 2011 benefit payments to be expended in FY11 are budgeted to be \$126,461,855 (No Other States Coverage). This is based on:
 - ✓ Actual ‘Accident Year’ benefit payments for each fiscal year from 1991 through April 30, 2010.
 - ✓ Benefits paid for each Accident Year 1991 - 2010 in FY09 and FY10 are used to calculate the accident year’s budgeted payments for FY11.
 - ✓ Accident year 2011 benefit payments are based on FY11 estimated Gross Earned Premium of \$171.5 million. Accident year 2011 benefit payments on insured losses are expected to be 12.9% of FY11 Gross Earned Premium.
- Other States Coverage (OSC) program benefit payments are estimated to be \$575,200 and are included in the amounts above. This is \$181,641 for indemnity and \$393,559 for medical.

Old Fund Benefit Payments

\$9,678,409 is budgeted for benefits and claim payments in the Old Fund. The Old Fund is in a claim run-off situation. No new claims are impacting the Old Fund. Once the Old Fund is depleted of assets the State of Montana General Fund is liable for payment of the ongoing Old Fund expenditures.

When estimating FY11 Old Fund benefit payments, the level of payment is conservatively weighted to ensure adequate funds are available for payment of statutorily required benefits. The budget for Old Fund benefit payments budget was estimated as follows.

- Benefit payments were estimated after analyzing prior year’s benefits paid by month. FY09 actual and FY10 projected benefits payments were the most heavily weighted data used for estimating the FY11 budget.
- As of April 30, 2010 year to date actuals, indemnity benefits are 23.7% of total benefits paid and medical is 76.3%. For FY11, it is estimated the ratios of indemnity and medical payments will be 23.4% and 76.6%, respectively.
- Old Fund benefit payments have been relatively stable for the past ten complete fiscal years as illustrated below.

<u>Fiscal Year</u>	<u>Benefit Payments</u>	<u>Percent Change from Prior Year</u>
FY11 Budget	\$9,678,409	12.0%
FY10 Projection	8,639,992	-20.3%
FY09 Actual	10,834,481	-1.4%
FY08 Actual	10,984,485	5.7%
FY07 Actual	10,395,247	-3.0%
FY06 Actual	10,716,620	5.1%
FY05 Actual	10,196,607	-16.7%
FY04 Actual	12,246,978	-10.3%
FY03 Actual	13,657,862	7.9%
FY02 Actual	12,655,663	-7.4%
FY01 Actual	13,663,892	4.1%
FY00 Actual	13,130,302	

V. Operational Expenditures

Operational expenditures include personal services, operating expenses, equipment and intangible assets, and Allocated Loss Adjustment Expense. The Building Project expenditures are identified separately to display relocation, furnishing and equipment costs anticipated for the move to the new building.

Operational Expenditures	<u>FY11 Budget</u>	<u>FY10 Projection</u>	<u>FY10 Budget</u>	<u>FY09</u>	<u>FY08</u>
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MSF (No Building Project)

FTE	284.50	299.50	299.50	298.00	298.00
Personal Services	\$22,304,891	\$22,093,281	\$22,770,780	\$21,172,011	\$21,992,109
Operating Expense	20,911,412	20,988,824	22,194,697	22,616,794	26,117,675
Equip & Int Assets	141,000	521,061	701,800	1,614,586	2,764,065
ALAE	4,361,386	4,367,396	4,233,879	4,267,691	4,149,015
Total MSF (No Building)	\$47,718,689	\$47,970,562	\$49,901,155	\$49,671,081	\$55,022,864

Building Project

Operating Expense	\$0	\$1,453,815	\$1,882,301	\$9,050	\$2,089
Equip & Int Assets	0	3,400,232	3,971,839	0	0
Total Building	\$0	\$4,854,047	\$5,854,140	\$9,050	\$2,089

Old Fund

Operating Expense	\$239,984	\$229,164	\$262,230	\$261,770	\$196,263
ALAE	245,166	248,385	339,758	290,973	303,171
Total Old Fund	\$485,150	\$477,549	\$601,988	\$552,743	\$499,434

Total	\$48,203,839	\$53,302,158	\$56,357,284	\$50,232,874	\$55,524,386
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MSF Staffing

The State Fund is requesting approval of 284.50 FTE (full time equivalent) for FY11. This is a net decrease of 15.00 FTE from the approved and current level of FY10's 299.50 FTE. MSF had 22 positions equating to 21.00 FTE that were vacant as of 5/24/10.

There were two positions established at 0.75 FTE each in FY10 that will be increased to 1.00 FTE each for FY11. Total increase is 0.50 FTE.

- Network Engineer in IT-Operations. This was a new position in FY10. The position is full-time and was effective as of 10/1/09. The FY11 increase will fund this position for the entire fiscal year.
- Underwriting Coordinator (SB-192) in OS-Underwriting Expert. This was a new position in FY10. The position is full-time and was effective as of 10/1/09. The FY11 increase will fund this position for the entire fiscal year.

There are eighteen positions comprising 15.50 FTE to be deleted beginning in FY11. These positions have been vacant during FY10. MSF continually re-aligns our staff to meet the changing work processes developed to most effectively and efficiently provide service to our customers.

The 284.50 FTE equate to 286 positions. In FY11, MSF will have 283 positions that are 1.00 FTE each and 3 positions that are 0.50 FTE each. The half FTE positions are:

- 2 Document Processor positions
- 1 Medical Case Manager position

The following table reflects MSF staffing by department for the FY11 Budget, FY10, FY09, and FY08.

MSF Department Staffing (FTE)	FY11 Budget	FY10	FY09	FY08
Corporate Support	30.00	32.00	34.00	35.25
Executive Offices	6.00	6.00	5.00	5.00
General Counsel	16.00	16.00	16.00	16.00
Human Resources	6.00	6.00	6.50	5.75
Information Technology	52.00	53.75	52.00	52.00
Operations	138.00	143.00	145.00	145.00
Operations Support	36.50	42.75	39.50	39.00
MSF Total	284.50	299.50	298.00	298.00

Personal Services

To support the necessary staff of 284.50 FTE, MSF requests funds of \$22,304,891 for the FY11 personal services budget. A vacancy savings factor of 3% was applied to the personal services estimates of Corporate Support, Information Technology, Operations, and Operations Support to reduce the budgeted amount.

	FY11 Budget	FY10 Projection	Dollar Variance	Percentage Variance
Salaries	\$17,115,764	\$17,003,411	\$112,354	0.7%
Employee Benefits	5,189,127	5,089,870	99,257	1.9%
Total Personal Services	\$22,304,891	\$22,093,281	\$211,611	1.0%

Regular Salaries - \$16,916,722

The Regular Salaries account code includes base salaries, merit based salary adjustments, and an adjustment for vacancy savings:

- \$16,621,832 for base salaries calculated on the hourly wage for all active employees as of March 14, 2010 with subsequent updates. Vacant positions were based on the compensation at 98% of mid-point for the positions expected pay band. FY11 will have 2,088 annual payroll hours for each FTE. Partial FTE salaries are prorated.
- \$294,890 for merit based salary adjustments. The merit salary adjustments for employees are paid after the final STAR (Skills, Talents and Results) process reviews are completed. For the FY11 budget an average merit adjustment of 2.5% was assumed. Merit salary adjustments have been budgeted to be effective September 11, 2010. No merit adjustments were budgeted for the President and Vice Presidents.

Overtime - \$14,346 – Supports workload coverage during the renewal period.

Personal Leave Program Payouts - \$104,184 – MSF's Personal Leave Program provides for the annual payment of unused personal leave balances of eligible participants. The FY11 budget estimate is based on FY10 payments and review of leave balances of participants.

Retirement Payouts – \$80,512 - Includes funds for leave balance payouts for seven expected retirements in FY10.

Employee Taxes and Benefits - \$5,189,127

Employee Taxes and Benefits are payments / contributions MSF makes on behalf of our employees, as a tax, or as worker's compensation premium. The following lists employee tax and benefit category, and the dollars budgeted.

- FICA / Medicare – 7.65% - \$1,284,493
- Retirement (PERS) – 7.17% - \$1,226,080
- Workers' Compensation Premium – 1.56% - \$266,763
- State Unemployment Tax (SUT) – 0.25% - \$42,829
- Group Insurance - \$2,368,963

HB13 enacted by the 2009 Legislature increased group insurance contributions for MSF to \$8,472 per eligible employee in FY11 from \$7,830 per eligible employee in FY10. This is an increase of \$642 or 8.2% per eligible employee. In FY11, MSF will have a maximum of 286 employees eligible for the insurance contribution. The estimated budget increase resulting from the HB13 increase in group insurance contribution is \$178,765 including an adjustment for vacancy savings.

Operating Expenses

The total budget for Operating Expenses is \$21,151,395 and includes funding for:

Category	FY11 Budget	FY10 Projection	Variance \$	Variance %
Other Services	\$15,011,728	\$15,926,987	(\$915,259)	-5.7%
Supplies & Materials	923,611	1,524,111	(600,500)	-39.4%
Communications	1,446,737	1,573,804	(127,067)	-8.1%
Travel	245,033	223,112	21,921	9.8%
Rent	317,990	348,628	(30,638)	-8.8%
Utilities	261,256	159,121	102,134	64.2%
Repairs & Maintenance	1,431,531	1,288,538	142,993	11.1%
Other Expenses	1,513,508	1,627,500	(113,992)	-7.0%
Total Operating Expenses	\$21,151,395	\$22,671,802	(\$1,520,407)	-6.7%

Operating Expenses - Other Services

- **Consulting and Professional Services** - \$2,545,144 – This is an increase of \$429,325 or 20.3% from the FY10 projection of \$2,115,819. The following are the areas of consulting and professional services expense in FY11. These expenses are needed to complete Strategic Business Plan initiatives and other operational aspects of MSF business.

Four budget areas requiring consulting and professional services expenditures comprise 82% of this category's budget. The following table summarizes these four areas and additional information is provided below.

Consulting and Professional Services

FY11 Budget	Department	Item / Description
\$856,476	Operations	NCCI Membership Fee Agreement and transaction based charges (membership required by law)
\$540,280	Various	Strategic Business Plan Initiative Projects
\$396,656	Operations	Other States Coverage
\$305,000	Executive / Old Fund	Actuarial services

- ✓ **National Council on Compensation Insurance (NCCI)** – \$856,476 – This is an increase of \$134,119 or 18.6% from the FY10 projection of \$722,357. The budget reflects the:
 - Current contract with NCCI that became effective January 1, 2010.
 - MSF net direct written premium from FY09. The NCCI Membership Fee is based on a percentage of premiums. Net direct written premium used to calculate the membership fee was \$206,218,078. Total FY11 budget for the Membership Fee is \$521,930.
 - Other fees are associated with the services provided by NCCI, such as eMods, unit statistical reporting, proof of coverage, and additional data.

MSF is charged a transaction fee when providing data to NCCI. These fees are budgeted to be \$334,545.

- No Credits were budgeted – NCCI has a program to provide members with credits, similar to a dividend program, based on NCCI's financial results. Incentives are also paid for accuracy in reporting. In FY09, through three quarters, MSF has received \$3,100 in credits, which are included in the FY09 projection. As the credits are not guaranteed and not in the control of MSF, MSF did not budget for the credits.
- ✓ **SBP Initiatives** - \$540,280 – Consulting and professional services portion of project budget only – expenditure by SBP Initiative project:
 - \$153,280 – Document Management System
 - \$150,000 – Enterprise Risk Management (ERM)
 - \$150,000 - Claim Quality Assurance (QA) Review and Improvement
 - \$75,000 – Business Team Alignment
 - \$8,500 – WorkSafe Champions
 - \$3,500 – Talent Retention / Knowledge Transfer
- ✓ **Other States Coverage (OSC)** – \$396,656 - The budget is based on total OSC premium of \$1,345,499. Per OSC contracts MSF pays 13.5% of the written premium as a fronting fee – FY11 budget \$181,641. Contracts provide for 12% of incurred losses as unallocated loss adjustment expense for expenses not attributable to a specific claim and are the cost of providing claims adjusting and supervision services required to support the classes of business reinsured under our agreement – FY11 budget \$161,015. A letter of credit is required of MSF per contract and budgeted costs are \$54,000.
- ✓ **Independent Actuary** - \$305,000 – This budget is for New Fund and Old Fund services related to rate levels, loss cost multipliers, loss reserves, equity and dividend analysis, and additional expenses associated with legislative session information requests. MSF is required by law to use the services of an independent actuary when estimating losses, dividends, and other areas of business. The budget breaks down as follows:
 - \$240,000 – New Fund - rate levels, loss cost multipliers, loss reserves, equity and dividend analysis
 - \$45,000 – Old Fund – loss reserves
 - \$20,000 – Actuarial services for special analysis during the legislative session
- ✓ **Other Consulting and Professional Services Items** - \$446,732
 - \$159,000 – Remote staff augmentation for PeopleSoft, SABHRS Upgrade, Business Intelligence, and Insurance Intelligence change request backlog
 - \$100,000 – Consulting services for business support deemed appropriate by the President
 - \$48,850 – Succession Planning
 - \$45,000 – Hay Group Compensation Consulting
 - \$40,200 – National Fraud Indexing service and asset searches

- \$30,600 – Novell migration
 - \$10,000 – Long term incentive planning and review
 - \$13,082 - All other: flu shots, STAR appeals, state day care expense, board member stipends, and occupational therapist ergonomic reviews
- **Insurance and Bonds** - \$249,089 – this is a minor decrease from the FY10 payment of \$249,295. All MSF insurance is provided through the State’s division of Risk Management and Tort Claims. The State is self-insured. This is a cost charged to MSF based on the Governor’s Office of Budget and Program Planning’s (OBPP) ‘Fixed Cost’ report.
- **Legal Fees and Court Cost** - \$100,000 - this is a decrease of \$8,149 or 7.5% from the FY10 projection of \$108,149. The budget will fund legal issues that are either pending or anticipated.
- **Warrant Writing** - \$53,840 – this is an increase of \$2,127 or 4.1% from the FY10 projection of \$51,713. CorVel issues checks for all medical related expenses but MSF relies on the State to issue all other warrants. The estimate is based on the OBPP Fixed Cost report.
- **Payroll Service Fee** - \$58,772 – this is a decrease of \$9,696 or 14.2% from the FY10 projection of \$68,468. The budget is based on OBPP Fixed Cost and will be charged to MSF for services of State’s Central Payroll and SABHRS Human Resource module.
- **Policyholder Payroll Audits** - \$749,957 – this is a decrease of \$1,650 or 0.2% from the FY10 projection of \$751,607. In FY10 the number of payroll audits performed has been reduced from the number of audits performed in FY09 (FY09 expense was \$908,918). For FY11, MSF plans to perform a similar level of audits as conducted in FY10. Historically, audits have had a favorable return on investment. However, this return on investment has decreased in FY10 as overall premium has decreased. Payroll audits continue to be a significant means to verify payrolls and ensure appropriate classifications are used as well as creating additional opportunities to educate policyholders on MSF processes for reporting payroll.
- **Financial and Legislative Audits** - \$85,454 – this is a decrease of \$6,053 or 6.6% from the FY10 projection of \$91,507.
- \$49,250 is for the Financial Compliance audit performed by the Legislative Audit Division (LAD) of the MSF governmental financial statements and includes \$20,000 for an expanded actuarial review.
 - \$36,204 is for an independent accounting firm to audit our annual statutory financial statements.
- **Consultants – Training** - \$192,512 – this is an increase of \$115,268 or 149.2% from the FY10 projection of \$77,244. The budget will enable MSF to bring trainers on-site and provide for a larger number of employees to participate in the

training rather than sending a limited number of employees to external locations to receive training.

- \$75,500 - training related to SBP Initiative projects (ERM-\$10,500; Talent Retention/Knowledge Transfer-\$15,000; Document Management System - \$50,000)
- \$39,200 - financial process/statement training
- \$24,538 - Claim Examiner customer service and negotiation skills
- \$20,942 - for Mosaic leadership training & for specialized medical staff
- \$10,000 – Investment in Excellence

- **Commissions** - \$10,639,192 – this is a decrease of \$1,130,908 or 9.6% from the FY10 projection of \$11,770,100 which includes base, incentive, and Other States Coverage commissions.

Commissions are the largest operating expense for MSF and are directly and proportionately related to gross premiums, percentage of MSF policyholders represented by agents, and the commission rates paid on a policy. The payment of commissions supports service and distribution capabilities with our agent partners.

Base Commissions:

In aggregate, MSF estimates FY11 gross earned premiums to be \$171,535,641, with agents representing 66.4% of this amount. The average base commission rate is 7.64%. This correlates to \$8,705,453 in base commission for FY11.

Incentive Commissions:

Incentive commissions are determined after reviewing how an agency's overall book of MSF represented accounts develops. The average agent incentive commission rate is expected to be 1.5% though not all agents may qualify for the incentive commission. \$1,683,745 is budgeted for the FY11 agent incentive commission.

Other States Coverage (OSC) Commissions:

\$107,640 is budgeted for commissions associated with OSC policies. The total FY11 revenue estimated for OSC is \$1,345,499. The average commission is 8%.

- **SABHRS Administrative Costs** - \$287,119 – this is a decrease of \$12,226 or 4.1% from the FY10 projection of \$299,345. This expense is paid to the Department of Administration and is MSF's portion of the expense for maintaining the state's accounting system, SABHRS. This expense is based on OBPP's Fixed Cost report.
- **Computer Services provided by the Information Technology Services Division (ITSD) of the Department of Administration** - \$579,562 – this is an increase of \$29,222 or 5.3% from the FY10 projection of \$550,340.

ITSD in conjunction with OBPP have determined the expenses to be charged to

MSF for services in the FY10 and FY11 Biennium for the services. MSF reviews processes and charges regularly and continually seeks the most efficient means to provide staff network support/services and to avoid the use of unnecessary or duplicative ITSD network services to minimize expense.

The budgets by category are as follows:

- ✓ \$215,699 – network services (62300 Communications)
 - ✓ \$179,848 – asset broker (62200 Supplies & Materials)
 - ✓ \$153,090 – enterprise services
 - ✓ \$21,568 – e-mail
 - ✓ \$9,087 – operations support
 - ✓ \$270 – laser print
- **Temporary Services** - \$88,669 – this is a decrease of \$293,905 or 76.8% from the FY10 projection of \$382,574. MSF uses temporary staff to fill in for vacancies as business needs require. As of May 24, 2010, MSF had 21.00 vacant FTE. Of these FTE, 15.50 FTE will be deleted effective July 1, 2010. The FY11 temporary services budget is allocated as follows:
- ✓ \$49,505 – SBP Initiative project – Talent Retention/Knowledge Transfer – budget will enable the backfill of positions temporarily vacated as part of the Mentor/Mentee program
 - ✓ \$27,664 - Information Technology administrative support
 - ✓ \$7,500 - Human Resource – to support MSFU deliverables
 - ✓ \$4,000 – General Counsel expert to assist with Mordja case.
- **Miscellaneous Information System Services - Non-DOA** - \$65,140 – this is a decrease of \$4,640 or 6.6% from the FY10 projection of \$69,780. This is primarily for disaster recovery services provided by SunGard.
- **Printing** - \$252,740 – this is an increase of \$38,710 or 18.1% from the FY10 projection of \$214,030. This includes in-house forms, safety workshop materials, a variety of small printing jobs for brochures, business cards, envelopes, and other informational materials.

Operating Expenses - Supplies and Materials

- **Computer Hardware** – \$11,981 – this is a decrease of \$934,162 from the FY10 projection of \$946,143. In FY10, MSF moved into our new building and as part of the building set-up all work stations were equipped with new personal computers and conference rooms were equipped with audio/visual equipment. The FY11 budget includes only peripheral computer equipment such as ergonomic keyboards, mice, and large screen monitors.
- **Minor Software** - \$440,289 – this is an increase of \$376,227 or 587% from the FY10 projection of \$64,062. Software to be purchased in FY11 includes:
- ✓ \$400,000 – SBP Initiative project – purchase of application software to support the Document Management System

- ✓ \$25,374 - Insurance industry database and annual statement preparation software
- **Supplies: Central Stores and Other Providers** - \$149,998 – this is a decrease of \$34,384 or 18.6% from the FY10 projection of \$184,383. This budget includes paper, toner, and a wide variety of minor office supplies.
- **Gasoline** - \$61,769 – this is an increase of \$13,950 or 29.2% from the FY10 projection of \$47,819. The budget estimate was based on \$3.259 per gallon (MSF is exempt from gas tax) for gasoline, an estimate of 22 miles per gallon on average, and an estimate of 18,953 gallons of gasoline being purchased. In FY11 MSF vehicles are projected to log 415,780 miles.
- **All Other Supplies and Materials Categories** - \$259,574 - includes budget for:
 - ✓ \$179,848 – asset broker – ITSD computer service charge to MSF (noted above) for enterprise software and licenses that also support MSF
 - ✓ \$28,523 – promotional aids to enhance safety and other program awareness
 - ✓ \$22,093 – educational materials: ‘Booke’ Seminar, Investment in Excellence, and ‘Through the Customer’s Eyes’
 - ✓ \$11,467 – books & reference materials
 - ✓ \$10,858 – minor office equipment
 - ✓ \$5,415 - diesel fuel for back-up generator
 - ✓ \$1,370 – all other

Operating Expenses - Communications

- **Postage** - \$357,930 – this is a decrease of \$41,175 or 10.3% from the FY10 projection of \$399,105. The budget includes:
 - ✓ \$228,000 - print mail service fees
 - ✓ \$125,000 - meter postage
 - ✓ \$4,930 – all other – meter scale updates, PO Box rental, field staff postage, postage due, and stamps
- **Advertising** (excluding recruitment advertising) - \$689,672 – this is an increase of \$116,299 or 20.3% from the FY10 projection of \$573,734. This will provide funding for all advertising campaigns to occur in FY11; media placement, newspapers, billboards, brochures and inserts, web design, direct mail, and opportunity marketing. Television advertising is \$263,158 and all other media is \$426,514.
- **Employment Ads** - \$30,500 – this is an increase of \$7,342 or 31.7% from the FY10 projection of \$23,158. This includes all in-state and out of state advertisements of MSF recruitments. This will be referenced later in the report encompassing all recruiting expenses.
- **All Telephone Categories** - \$150,917 – this is a decrease of \$231,580 or 60.5% from the FY10 projection of \$382,497. This expense covers cell phones, long-

distance, private lines, and '800' line services. The significant decrease to FY11 from FY10 is due to MSF's purchase of a new phone system as part of the new building. This included phone equipment which reduced charges from ITSD for telephone equipment by an estimated \$235,000.

Operating Expenses - Travel

- \$245,033 – this is an increase of \$21,921 or 9.8% from the FY10 projection of \$223,112. The budget will support MSF staff attending training at off site locations and this also includes travel by safety management, claim examiners, and underwriters to visit customers. This also covers travel associated with WorkSafe MT and the agency advisory committee.

Operating Expenses - Rent

- \$317,990 – this is a decrease of \$30,638 or 8.8% from the FY10 projection of \$348,628. Parking expense for FY11 will be \$243,600 which is a \$140,600 increase from projected FY10 parking expense. All other rent categories decrease as leased space for the MSF building and two other locations housing MSF personnel locally will not be required due to staff moving into the new building.

Operating Expenses - Utilities

- \$261,256 – this is an increase of \$102,134 or 64.2% from the FY10 projection of \$159,121. This is for electricity, natural gas, and water and sewage associated with the new building.

Operating Expenses - Repairs and Maintenance

- \$1,431,531 – this is an increase of \$142,993 or 11.1% from the FY10 projection of \$1,288,538. The bulk of this expense is due to IT maintenance agreements (\$1,021,779) for hardware such as servers, routers and associated peripherals, and application software. Facilities budget for maintenance agreements (\$356,783) includes janitorial services, heating, air conditioning and ventilation (HVAC), snow removal and other items.

Operating Expenses - Other Expenses

- **Dues** - \$64,519 – this is an increase of \$41,809 or 184.1% from the FY10 projection of \$22,710. This expense is for membership dues with professional business organizations such as the Montana Society of CPA's, Montana Chamber of Commerce, and the Society for Human Resource Management.
- **Subscriptions** - \$84,573 – this is an increase of \$24,517 or 40.8% from the FY10 projection of \$60,056. This includes budget for a variety of subscriptions for desk manuals and career specific periodicals such as medical and occupational disability guides and on-line access, A.M. Bests materials, National Safety Resource Center, and NCCI manuals.
- **Taxes and Assessments** - \$323,332 – this is a decrease of \$28,464 or 8.1% from the FY10 projection of \$351,795. This budget is comprised of three pieces; Old

Fund Assessments paid to the Department of Labor and Industry, Other States Coverage (OSC) premium taxes, and property taxes on the new building.

- ✓ \$194,976 - Old Fund Administrative Assessment (\$170,241) and Subsequent Injury Fund Assessment (\$24,736). These are regulatory assessments from the Department of Labor and Industry as provided in law. The budget is based on the invoice provided by the Department of Labor and Industry's Employment Relations Division for FY11. There will be no expense for the Rehabilitation Assessment in FY11.
- ✓ \$122,640 - OSC Premium Taxes – This is for premium taxes paid for insuring MSF policyholder's operations in other states where workers' compensation premium taxes are assessed. In FY11 the OSC premiums are estimated to be \$1,345,499 and the taxes and surcharges are estimated to be 9.1%.
- ✓ \$5,716 - Property assessment on the new building
- **Education and Training** - \$97,051 – this is a decrease of \$13,056 or 11.9% from the FY10 projection of \$110,107. MSF maintains a philosophy to provide training to employees in necessary aspects of the business to ensure corporate success. Training is needed to ensure MSF employees are knowledgeable in best practices associated with claim management, safety management and underwriting of risk.
- **Rewards** - \$19,538 – this is an increase of \$2,992 or 18.1% from the FY10 projection of \$16,546. This is for employee of the month/year awards, employee referral incentives, certification awards, and IDEA awards.
- **Tuition Reimbursement** – \$45,000 – this is an increase of \$23,687 or 111.1% from the FY10 projection of \$21,313. For FY11, the maximum amount of annual tuition reimbursement per employee is \$4,000. Twelve employees are expected to participate in the tuition reimbursement program in FY11. Reimbursements are based on successful course completion and actual cost.
- **Meetings and Conference Cost** - \$136,529 – this is a decrease of \$19,903 or 12.7% from the FY10 projection of \$156,432. The budget provides for meeting rooms and equipment for all MSF meetings that cannot be held in our building.
 - ✓ Safety management workshops in locations throughout Montana
 - ✓ Agent training workshops
 - ✓ Marketing events throughout the state
- **Recruitment Expenses** (excluding Employment Advertising) - \$271,875 – this is a decrease of \$5,723 or 2.1% from the FY10 projection of \$277,598. Employee recruitment is necessary to fill vacancies resulting from employee turnover.

Through April of FY10, MSF had 44 'recruitment actions' (includes new hires, promotions, and transfers). Each action has the potential to require different levels of expense to complete the recruitment process. The FY11 budget is based on prior year expenditures for individual recruiting actions and an expectation of lower recruiting actions being necessary in FY11.

Recruitment expenses including advertising are \$302,375 and are comprised of the following accounts:

- ✓ Employment Ads - Out-of-State – \$12,000
- ✓ Employment Ads - In-State – \$18,500
- ✓ Relocation – Taxable – \$18,930
- ✓ Recruiting – Non-Advertising - \$7,095
- ✓ Job Candidate Expense – recruitment services & candidate travel expenses – \$163,200
- ✓ Relocation – Non-Taxable – \$82,650

➤ **Charitable Contributions / Scholarships** - \$46,500 – this is a decrease of \$4,270 or 8.4% from the FY10 projection of \$50,770. The total funds available for charitable contributions, \$46,650, were based on 0.03% of estimated FY11 net earned premium. Charitable Contributions are expended through:

- ✓ \$13,850 - ACE (Assisting Charitable Endeavors) Grants program - The grants are awarded by a committee of MSF employees based on applications submitted by not for profit organizations throughout the state.
- ✓ \$26,650 – Scholarship program – Scholarships of up to \$2,000 per year are provided to dependents or spouses of MSF insured employees who died in work related accidents. MSF estimates 13 scholarships will be awarded in FY11 for a total budget of \$26,650. Each scholarship is estimated to be \$2,000 with an additional \$50 administrative fee each. The budget is based on prior year participation.
- ✓ \$5,000 – Leadership Montana
- ✓ \$1,000 – ‘Festival of Trees’

➤ **Fee Collection Expense** - \$70,490 – this is an increase of \$7,446 or 11.8% from the FY10 projection of \$63,045. MSF contracts with three collection agencies and the fee varies based on success with collections and whether litigation is involved.

➤ **State Wide Indirect Cost** - \$326,736 – this is an increase of \$26,640 or 7.5% from the FY10 projection of \$353,376. The State Wide Indirect Cost (also known as the State Wide Cost Application Plan or SWCAP) is an allocation determined by the Office of Budget and Program Planning as a means to allocate cost incurred by agencies whose functions support all state entities.

Equipment and Intangible Assets

The total FY11 budget for equipment and intangible assets is \$141,000. This is a decrease of \$3,780,293 or 96.4% from the FY10 projection of \$3,921,293, as FY11 will not have the level of purchases that occurred in FY10 associated with the new building.

Equipment

➤ **Autos & Trucks** - \$84,000 - Replacement vehicles as recommended by the Fleet Manager. Vehicles being replaced have reached the mileage specified in MSF’s Fleet Management Policy as the replacement threshold. The budget will replace four vehicles in FY11 from our fleet of twenty-two MSF owned vehicles.

Intangible Assets

- **Multi-User Software** - \$57,000
 - ✓ \$32,000 – PowerBuilder and Oracle Tuning and diagnostics for data center optimization
 - ✓ \$25,000 – MSF University tracking software

Allocated Loss Adjustment Expense (ALAE)

ALAE are costs directly associated with managing a specific claim, such as independent medical examination to analyze a prescribed treatment of an injured employee.

\$4,606,552 is budgeted to the New Fund and the Old Fund for ALAE:

- New Fund - \$4,361,386
- Old Fund – \$245,166

ALAE is expected to decrease by \$9,230 or 0.2% from the FY10 projection of \$4,615,782.

- \$2,259,891 – Corvel contracted cost for reviewing and processing medical invoices – an increase of \$66,005 or 3.0% from the FY10 projection of \$2,193,886.
- \$1,205,726 – All legal expense categories - this is an increase of \$35,177 or 3.0% from the FY10 projection of \$1,170,549.
 - ✓ \$594,000 - Legal Cost Allocation – cost of in-house legal staff working on claim file issues.
 - ✓ \$408,292 – State Fund Legal Contract
 - ✓ \$172,139 – Legal Fee Claimant Attorney
 - ✓ \$31,295 – Employer’s Liability Insured Defense Cost
- \$999,335 - Fraud Related ALAE - this is an increase of \$23,799 or 2.4% from the FY10 projection of \$975,536.
 - ✓ \$730,203 - Private Investigations
 - ✓ \$269,132 – Department of Justice Fraud (DoJ) Agreement – MSF uses the services of DoJ to complete investigations submitted to them by MSF and prosecutes workers’ compensation fraud cases. DoJ has police powers that enable them to more thoroughly complete fraud investigations and prosecutions than MSF. The total budget of \$289,132 is an increase of \$6,564 or 2.3% from the FY10 projection of \$282,568. The budget is distributed to the Fraud Services team (\$20,000) and the New Fund (\$269,132) based on actual investigative and prosecutorial hours recorded.
- \$62,571 – Medical Consultants – this is a decrease of \$2,294 or 3.5% from the FY10 projection of \$64,865.
- \$71,258 – Contract Adjusters - this is a decrease of \$132,787 or 65.1% from the FY10 projection of \$204,045.
 - ✓ \$30,273 – Adjusters associated with Other States Coverage claims
 - ✓ \$40,985 – Adjusters for MSF in-house claims

Costs not included in the Proposed Budget

The FY11 budget includes all known and expected costs for the fiscal year. The budget does not include:

- Merit and management incentives plan adjustments for the President. This is a separate Board action to be taken in September 2010.
- Merit adjustments for the vice presidents.
- Court decisions which may significantly and adversely impact the State Fund. No such decisions are currently anticipated.
- Employee Incentive Program (Goal Sharing).

Should the Board take action on these items, we will include the adjustments in the budget as appropriate.

The FY11 Budget is prefaced on MSF's net earned premium projection of \$153.9 million. Should premium significantly increase or decrease from the estimate, appropriate budget increases or decreases may be presented to the Board for further review.